

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

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**Central Illinois Light Company**

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**Docket No. ER98-2440-002**

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**COMMENTS OF THE ILLINOIS COMMERCE COMMISSION**

Pursuant to Rule 211 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.211, the Illinois Commerce Commission ("ICC") hereby submits its Comments in the above-captioned proceeding. The ICC respectfully requests that the Commission replace the "hub-and-spoke" test with the delivered price test, which the Commission developed for review of merger applications, to evaluate the existence of market power when reviewing market-based rate applications in this as well as all future utility market-based rate proceedings. The ICC also requests that the Commission require CILCO to notify the Commission of any significant changes in status affecting its market-based rate authority within 10 days.

**I. BACKGROUND**

On June 1, 2001, Central Illinois Light Company ("CILCO"), a wholly owned subsidiary of AES Corporation, filed its updated triennial market power analysis in compliance with the Commission's June 2, 1998 "Order Accepting for Filing Proposed Tariff for Market-Based Power Sales and Reassignment of Transmission Capacity and Granting Waiver of Notice."<sup>1</sup> In its update, CILCO acknowledges that the continuance of market-based rate authority is contingent on its ability to

demonstrate that CILCO and its affiliates do not have, or have adequately mitigated, market power in both generation and transmission, and cannot erect barriers to entry. CILCO Filing at 4 (citing Toledo Edison, 78 FERC ¶61,013 (1997); Montana Power Company, 78 FERC ¶61,005 (1997)).

The cornerstone of CILCO's filing is the generation study prepared by J. Stephen Henderson in Appendix A. This is the same analysis that was filed on November 8, 2000, by CILCO's affiliate, NEV, L.L.C. See, Updated Market Power Analysis, NEV, L.L.C., NEV East, L.L.C., NEV California, L.L.C., NEV Midwest, L.L.C., Docket Nos. ER97-4636, ER97-4652, ER97-4653, ER97-4654, 65 FR 70340 (noticed Nov. 22, 2000). Specifically, Mr. Henderson employs the hub-and-spoke methodology that the Commission routinely uses to evaluate applications for market-based rate authority. Mr. Henderson concludes that the market shares of NEV and its affiliates are below the thresholds used by the Commission to indicate the need for further review in all relevant markets and that NEV lacks generation market power under the Commission's guidelines. CILCO Filing App. A at 14. On December 12, 2000, the Commission accepted NEV's updated market power analysis via letter order. NEV, L.L.C., Docket Nos. ER97-4636, ER97-4652, ER97-4653, ER97-4654, 66 FR 7640 (noticed Dec. 24, 2000).

CILCO now asserts that the market power analysis and the Commission's conclusion based thereon apply equally to CILCO because CILCO's only affiliates are the same as NEV's affiliates. CILCO Filing at 5. CILCO contends that Mr. Henderson's market analysis has not changed in any material way since it was filed with the Commission, and CILCO has also provided a verification from Robert G. Ferlman attesting that "CILCO does not own any generation sources other than those referenced" in Mr. Henderson's analysis. See, CILCO Filing at App. A. CILCO, therefore, requests

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<sup>1</sup> Central Illinois Light Company, Docket No. ER98-2440-000, 83 FERC ¶61,252 (1998).

continued authorization to sell power at market-based rates based on the Commission's approval of the NEV filing as well as the AES Medina filing.<sup>2</sup> CILCO Filing at 6.

## **II. ICC POSITION AND RECOMMENDATION**

The Illinois Public Utilities Act ("PUA") charges the ICC with regulating public utilities in the State of Illinois. 220 ILCS 5/1-101 et seq. As part of the ICC's regulatory duties, the ICC is required to ascertain that public utilities' rates, charges, and rules and regulations relating to rates and charges for retail service within Illinois are just, reasonable and non-discriminatory. 220 ILCS 5/9-101 to 5/9-252. The ICC is also statutorily directed to "act to promote the development of an effectively competitive electricity market that operates efficiently and is equitable to all consumers." 220 ILCS 5/16-101A(d). This statutory direction is based on the Illinois General Assembly's finding that "a competitive wholesale and retail market must benefit all Illinois citizens." Id.

Given the aforementioned statutory framework, the ICC requests that the Commission reject the application of the so-called "hub-and-spoke" method of market power analysis to market-based rate filings, such as CILCO's in the instant case, and apply a more appropriate market power screening methodology, known as the delivered price test.<sup>3</sup> The hub-and-spoke methodology is flawed as a market power-screening device. The hub-and-spoke test fails to accurately assess the ability of a power seller to exercise market power. The delivered price test, in contrast, is a more accurate market power screening methodology and is routinely applied by the Commission in its review of merger

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<sup>2</sup> AES Medina is a CILCO affiliate that plans to build, own, operate and maintain a 40 MW gas-fired cogeneration unit located in Mossville, Illinois. Via letter orders issued on March 3, 2001 and April 11, 2001, respectively, in AES Medina Valley Cogen, L.L.C., Docket No. ER01-1381, the Commission approved AES Medina's request for Exempt Wholesale Generator status, 66 FR 15111 (noticed Mar. 15, 2001), and the associated market-based rate schedule, 66 FR 23016 (noticed May 7, 2001).

<sup>3</sup> As discussed infra at subsection B, the Commission developed the delivered price test for application in its review

applications. The ICC, therefore, urges the Commission to decline to use the hub-and-spoke methodology in reviewing the CILCO filing in this proceeding and replace it with the more sophisticated methodology underlying the delivered price test. If CILCO successfully passes the delivered price test in this proceeding, continuation of CILCO's authority to charge market-based power rates should be granted.

The ICC further recommends that the Commission apply the delivered price test to all subsequent applicants seeking market-based rates.<sup>4</sup> Applicants who are able to pass the hub-and-spoke test but who, nevertheless, have the ability to exercise market power make it difficult or impossible for states, such as Illinois, to develop competitive retail markets. The ICC is concerned that the exercise of market power in wholesale markets will hinder the "development of an effectively competitive electricity market that operates efficiently and is equitable to all consumers," in contravention of the directives to the ICC in the Illinois Customer Choice Law.

In addition to its recommendation that the Commission adopt the more sophisticated delivered price test, the ICC urges the Commission to require CILCO to modify its statement that CILCO will notify the FERC of any change in the information upon which the FERC has relied in granting CILCO market-based rate authority in this case. CILCO Filing at 8. In the past, the Commission has allowed utilities like CILCO the option of including such notifications in their triennial market power updates. The ICC contends that a three-year time period is too lengthy given the rapid developments in the electricity marketplace today.<sup>5</sup> Consequently, the ICC recommends that notification be required within

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of merger applications. Order No. 592, Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act, 61 F.R. ¶68,595, Docket No. RM96-6-000 (1996).

<sup>4</sup> The ICC notes that "all subsequent cases" would include Exelon Generation Company, which is scheduled to undergo its triennial review in 2003.

<sup>5</sup> Commissioner Massey has stated his agreement with this aspect of the ICC's position:

ten days of any change in relevant information.

### **III. DISCUSSION**

#### **A. The Commission Should Discontinue Use of the Hub-and-Spoke Methodology in its Review of Market-Based Rate Applications.**

##### **1. The Hub-and-Spoke Model and Its Deficiencies**

The Commission routinely employs a hub-and-spoke analysis in its review of market-based rate applications. A hub-and-spoke analysis measures market shares in the markets for total installed generating capacity and uncommitted generating capacity<sup>6</sup> within the applicant's service area and in first-tier interconnected markets, i.e., those markets directly interconnected with the applicant. The hub-and-spoke methodology has been developed and applied by the Commission to a number of different types of sellers over the last ten years, beginning with independent power producers and unaffiliated marketers and proceeding to traditional investor-owned utilities and their affiliates. See e.g., Heartland Energy Services, Inc., 68 FERC ¶ 61,223 (1994).

The hub-and-spoke methodology requires an applicant to perform a separate analysis for its own service area and for each utility service area that is directly interconnected with the applicant. See e.g., New York State Electric & Gas Corp., 78 FERC ¶ 61,309 at ¶ 62,328 (1997). With respect to an applicant's own service territory, the applicant is required to compare its controlled generating capacity to the sum of: (1) the generating capacity controlled by itself; (2) any alternative generating

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Although I understand that the Commission has employed this approach - allowing the company to report significant changes up to three years after they occur - for many years in regulating market-based rates under the Federal Power Act, this is not the approach we take in regulating natural gas pipelines. For pipelines and storage facilities, the Commission requires notification within ten days of changes affecting the market power analysis. I believe the time has come for the Commission to reexamine its policy on reporting changes in status. Three years is simply too long to wait for notification of significant changes in status that could affect the efficacy of a market-based rate determination.  
Exelon Generation Company, 95 FERC ¶61,309 (2000)(Massey, dissenting).

capacity in the service area; and (3) all generating capacity in the first tier utilities. Id. The Commission has stated that its traditional hub-and-spoke generation dominance analysis “examines the relative size of the sellers as a measure of the ability of a utility to dominate electricity supply in a geographic market or to raise prices by withholding capacity.” Id.

The hub-and-spoke methodology suffers from several deficiencies that make its continued use by the Commission inadequate to evaluate market power. Specifically, the test results in inaccurate definitions of geographic markets as well as inaccurate identifications of alternative available generation suppliers. Indeed, in the Commission’s Merger Policy Statement, the Commission conceded the deficiencies associated with the hub-and-spoke model and its inability to accurately define the appropriate markets at issue. In particular, the Commission noted as follows:

An accurate assessment of the effect on markets depends on an accurate definition of the markets at issue. The Commission’s current analytic approach [hub-and-spoke] defines geographic markets in a manner that does not always reflect accurately the economic and physical ability of potential suppliers to access buyers in the market.

Order No. 592, Inquiry Concerning the Commission’s Merger Policy Under the Federal Power Act, Docket No. RM96-6-000, 61 FR 68,595, slip op. at 20 (1996). These infirmities render the hub-and-spoke test virtually meaningless in light of the rapidly changing electricity marketplace.

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<sup>6</sup> CILCO only provides data in this proceeding on installed generating capacity for the CILCO markets.

a) *Inaccurate Definitions of Geographic Markets*

The hub-and-spoke methodology does not produce accurate definitions of geographic markets because it does not account for transmission import limitations and transmission constraints in defining the relevant markets. For example, the Commission recently decided to establish the entire state of California as a relevant market for determining market power pursuant to the hub-and-spoke methodology, failing to account for the significant transmission limitations between Northern and Southern California.<sup>7</sup> Transmission system factors are critical in assessing the ability of generators outside the applicant's service area to compete with generators inside the applicant's service area to serve load inside the applicant's service area.

The use of a market power screen that accounts for transmission system factors is particularly critical in this case given that transmission import limitations into Illinois and throughout the Midwest are becoming increasingly significant. See, Staff Report, Investigation of Bulk Power Markets: Midwest Region, Table 2-10 (Nov. 1, 2000). Over the last three years, the Mid American Interconnected Network ("MAIN"), East Central Area Reliability Council ("ECAR"), Southwest Power Pool ("SPP"), and Mid-Continent Area Power Pool ("MAPP") experienced 685 Transmission Loading Reliefs ("TLRs") of Level 2 or greater. Id. Roughly 72%, or 492, of those TLRs occurred in the summer of 2000. Id. Over 87% of all TLRs occurred in the MAIN and ECAR regions, with almost half of them attributable to MAIN. Id. In fact, in a filing made on April 6, 2001, CILCO admitted that for the summers of 1999 and 2000, it had difficulty obtaining energy from the market to serve its retail load due to shortages of available transmission capacity. See, Power Purchase Agreement Filing, Altorfer Inc., Docket No. ER01-1758, 66 FR 20144 (noticed Apr. 19, 2001).

*b) Inaccuracies Regarding Alternative Available Generation Suppliers*

In addition to its inaccurate definitions of geographic markets through inadequate consideration of transmission constraints, the hub-and-spoke model produces inaccurate identifications of alternative available generation suppliers. The hub-and-spoke model incorrectly defines the universe of available supply alternatives by concluding that customers can receive service from numerous suppliers, when in fact, they cannot. The hub-and-spoke model does not account for unit operating costs, unit operating characteristics, unit commitment and unit dispatch. These financial feasibility factors are critical in assessing the likely response of other generation suppliers as substitutes for applicants' generation for serving load inside applicants' service areas. Without accurate identifications of the alternative suppliers that represent real, competitively priced options, one cannot ascertain whether there are workably competitive markets to restrain applicants for market-based rates from raising prices above competitive levels.

In short, market concentration results generated by the hub-and-spoke model are not meaningful, and conclusions about sellers' abilities to exercise market power derived from those market concentration results cannot be legitimately used to assess the state of markets and should not, therefore, be relied upon to approve market-based rate requests. Indeed, as a result of these deficiencies, the hub-and-spoke model has been widely criticized by state commissions, citizen interest groups, transmission customers, and others. Commissioner Massey recently expressed his concerns as follows:

First, we need to upgrade our anachronistic analytic standards. For starters, the Commission still uses the antiquated "hub and spoke" method of evaluating market

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<sup>7</sup> Duke Energy Moss Landing, L.L.C., 83 FERC ¶61,317 (1998)



power when awarding market-based rates. This method takes no cognizance of various load levels or of costs or prices of competitors, nor does it take into account transmission capacity when evaluating supply to a market. Any market participant that cannot pass this test needs a new lawyer. How accurate can this test be? How much faith can state commissioners have in our market based pricing policy if we still use this horse and buggy analytic approach? Relying upon the hub and spoke is sheer folly.

Commissioner William Massey, Is FERC Keeping Its Part of the Regulatory Bargain, Address to the Energy Bar Association (Feb. 8, 2001). It is time for the Commission to respond to these concerns by discontinuing its reliance on the hub-and-spoke methodology for detecting generation market power

## **2. The Commission's Stated Reasons for Continued Use of the Hub-and-Spoke Methodology Are Not Persuasive.**

The Commission has previously addressed requests to replace the hub-and-spoke test in market-based rate analyses. See, Consolidated Edison, 78 FERC ¶61,298 (1997); Exelon Generation Company, 95 FERC ¶61,309 (2001). In Consolidated Edison, the Commission dismissed intervenors' proposals that the Commission employ the delivered price test to requests for market-based rates. The Commission stated that "it is neither necessary nor appropriate to change the market power screen [hub-and-spoke] analysis that we [the Commission] traditionally have used to analyze market-based rate applications." 78 FERC ¶61,298.

The Commission has attempted to justify its continued use of the flawed hub-and-spoke test by drawing distinctions between market-based rate application cases and utility merger cases, in which the Commission employs the delivered price test. Specifically, in Consolidated Edison, the Commission offered three reasons for why it believes it is appropriate to retain the less rigorous hub-and-spoke market power analysis method in market-based rate application cases: (1) mergers involve structural corporate changes in the marketplace and a merger, once consummated, cannot easily be undone; (2)

the Commission is required by statute to take initial action on a completed market-based rate application within 60 days and, of necessity, must use a market screen analysis which it is capable of applying within that short time frame; and (3) an extensive market power screen analysis is not necessary because of the Commission's ability to monitor and remedy market power abuses by utilities charging market-based rates. Id. These explanations, however, do not justify retention of the hub-and-spoke methodology to analyze market-based rate applications.

First, the ICC agrees that market damage from improper mergers is not easily remedied. However, neither is market damage arising from improper approvals of market-based rates. In fact, as discussed below in subsection D, the exercise of market power in nascent electricity markets can prevent the effective development of competition within those markets, thereby imposing significant damage that is not easily remedied.

Second, the statutory requirement to review market-based rate applications within 60 days does not justify utilizing a less comprehensive market-power analysis. The Commission has a statutory duty to perform reasoned evaluations of market-based rate applications that cannot be disregarded because of a requirement to perform the evaluations quickly. In other words, the Commission should adopt both a test that it can perform within 60 days as well as one that yields accurate results.

Moreover, the Commission should have the ability to perform reasoned evaluations, such as those the Commission performs in reviewing merger applications, within the 60-day timeframe. The Commission has previously accepted the delivered price test as a substitute for or in addition to the traditional hub-and-spoke model, and processed the results within 60 days. To illustrate, in New York State Electric & Gas Corp., the Commission allowed, although it did not require, applicants for market-based rates to submit delivered price test analyses, or other alternative approaches, along with their

hub-and-spoke analyses in order to “present a more accurate picture of the market,” 79 FERC ¶ 61,303 (1997), or as a substitute for the traditional hub-and-spoke analysis. 78 FERC at ¶ 62,329 n.7. Indeed, provided that the criteria that must be applied by utilities in performing the more comprehensive test is clearly specified ahead of time, the amount of time necessary for Commission review of utilities’ filings should be reduced. Accordingly, if the Commission were to adopt a standardized, yet more comprehensive, delivered price test market power analysis to be applied by applicants for market-based rates, the 60-day clock should not constitute a constraint.

Third, the Commission’s reliance on monitoring the market for competitive failures and market power abuses after-the-fact is not as effective as conducting thorough and complete analyses of market power at the time of application and rejecting those applications where the analyses demonstrate the existence of market power. Performing market monitoring functions is extensive, complicated work. As a result, it is likely that market power abuses can remain undetected despite efforts by the Commission to perform a market monitoring function.<sup>8</sup> Even if market power abuses are detected, once corrective efforts are started, additional time is required for investigation and, quite likely, litigation. Accordingly, a wait-and-see approach allows market power abuses to develop and harm market participants as well as consumers before market power abuses are detected and even while attempts are being made to correct the problems. These time constraints in detecting and correcting abuses of market power merely give the utilities possessing such market power opportunities to exercise market power and entrench themselves as the dominant firms in the markets, thereby resulting in further future damage to the other market participants and consumers.

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<sup>8</sup> In fact, it appears that recent efforts by the Commission to monitor the market for market failures and abuses may not be proceeding as the Commission had anticipated which, in part, could be the result of the extensive amount of monitoring work necessitated by the Commission’s continued employment of the hub-and-spoke analysis.

Ultimately, by continuing to employ an inadequate market power analysis methodology to evaluate market-based rate applications, the Commission fosters the ability of power sellers to exercise market power while further burdening the Commission's ongoing market monitoring team. If the Commission's market monitoring team is indeed overburdened, then this is strong evidence that the Commission's current use of the hub-and-spoke market power screen in market-based rate applications is allowing too much in the way of market power conditions to slip through. The Commission, therefore, should use the opportunity before it in this proceeding to remedy this situation by replacing the hub-and-spoke model with the more meaningful delivered price test market power analysis.

**B. The Commission Should Replace its Current Use of the Hub-and-Spoke Model when Reviewing Market-Based Rate Applications with the Merger Policy Statement Appendix A Delivered Price Test.**

As Commissioner Massey has acknowledged, the hub-and-spoke model is an "anachronism" that should be superseded by a more sophisticated approach to market power analysis.<sup>9</sup> Indeed, as early as 1996, the Commission recognized the problems associated with applying the traditional hub-and-spoke market power analysis in merger applications. In its Merger Policy Statement, the Commission developed the alternative, more rigorous, delivered price test market power analysis to be applied in those circumstances. The Commission summarized the steps in its new methodology as follows:

- (1) Identify the relevant products. Relevant products are those electricity products or substitutes for such products sold by the merging entities.
- (2) Geographic markets: identify customers who may be affected by the merger.

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<sup>9</sup> See, Exelon Generation Company, L.L.C., 95 FERC ¶61, 309 (2001)(Massey, dissenting).

Generally, these would include, at a minimum, all entities directly interconnected to a merging party and those that historical transaction data indicate have traded with a merging party.

- (3) Geographic markets: identify potential suppliers that can compete to serve a given market or customer. Suppliers must be able to reach the market both physically and economically. There are two parts to this analysis. One is determining the economic capability of a supplier to reach a market. This is accomplished by a delivered price test, which accounts for the supplier's relative generation costs and the price of transmission service to the customer, including ancillary services and losses. The second part evaluates the physical capability of a supplier to reach the customer, that is, the amount of electric energy a supplier can deliver to a market based on transmission system capability.
- (4) Analyze concentration.<sup>10</sup> Concentration statistics must be calculated and compared with the market concentration thresholds set forth in the Guidelines.

Order No. 592, slip op. at 26.

The test adopted by the Commission for review of market power in merger application cases is superior to the hub-and-spoke methodology because it considers all relevant factors, i.e., energy prices, transmission capacity and transmission prices, factors which the hub-and-spoke methodology ignores. Further, in addition to market concentration data, which the above factors represent, the delivered price test provides a mechanism to consider other factors that allow for a more sophisticated market power analysis such as prevailing market rules, demand response and past market behavior. Commissioner Massey has explained the latter aspect of the delivered price test as follows:

This approach [the delivered price test] also takes account of the time dimension of supply and demand. By that, I mean that it is capable of analyzing horizontal slices of the supply curve at various load levels such as peak, super peak, off peak and shoulder to measure supplier concentration.

Sithe Edgar, L.L.C., 93 FERC ¶61,193 (2000)(Massey, concurring).

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<sup>10</sup> To apply the delivered price test model to market-based rate applications, the appropriate market concentration thresholds, referenced in Step 4, would need to be considered.

It may even be appropriate, as Commissioner Massey recommended in his recent dissent in Exelon Generation Company, for the Commission to go beyond examining the market concentration data generated by the delivered price test when conducting reviews of market-based rate applications. The ICC agrees that it is beneficial to consider such factors in a market power analysis. However, it is most critical that the Commission begin by replacing the antiquated hub-and-spoke method of measuring market concentration with the more accurate delivered price test. The ICC recommends that the Commission take that initial step in this case.

**C. The Commission Has the Authority to Depart from Past Precedent and Failure To Do So in this Instance Could Constitute Arbitrary and Capricious Decision-Making.**

In spite of the many shortcomings of the hub-and-spoke methodology described herein, the Commission has recently denied requests from state commissions including the ICC, States Attorney General, transmission customers and others to discard the inherently flawed hub-and-spoke screen in favor of a more comprehensive method of analysis used in market-based rate cases. See e.g., Exelon Generation Company, L.L.C., 93 FERC ¶61,140 (2000), reh'g denied, 95 FERC ¶61,309 (2001); New England Power Company, et. al., 82 FERC ¶61,179 (1998); New York State Electric & Gas Corporation and XENERGY, Inc., 78 FERC ¶61,309 (1997); XENERGY, Inc. and New York State Electric & Gas Corporation, 79 FERC ¶61,303 (1997); Consolidated Edison of New York, Inc. and ProMark Energy, Inc., 78 FERC ¶61,298 (1997). Most recently, in Exelon Generation Company, the Commission denied the ICC's request that the Commission only approve Exelon's market-based rate application on the condition that Exelon perform and submit the delivered price test market power analysis in a de novo review of Exelon's market-based rate authority request in 2003. 93 FERC

¶61,140, slip op. at 13.

Although the Commission has previously denied requests to discard its use of the hub-and-spoke methodology, the Commission is not required to maintain the status quo. It is well established that the Commission has the authority to depart from prior precedent or settled policy as long as a reasoned analysis is provided that justifies the change. See, Mobile Oil Corp. v. EPA, 871 F.2d 149 (D.C. Cir. 1989)(finding that an agency's new interpretation of statutory language is entitled to deference "so long as the agency acknowledges and explains the departure from its prior views"). The analysis provided herein constitutes a more than adequate basis for a reasoned departure from the Commission's past decisions.

Moreover, not only is the Commission authorized to make a reasoned departure from its past precedent by replacing the hub-and-spoke methodology with the more comprehensive delivered price test, but the Commission could also be perceived as acting arbitrarily and capriciously if it fails to adopt a more comprehensive, reliable and accurate method of market power analysis. A court reviews, under the arbitrary and capricious test, whether the agency engaged in reasoned decision-making, which includes whether the agency considered all "relevant factors." Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 416 (1971). In other words, adherence to past precedent may not result in reasoned decision-making if it does not permit, in any given instance, the Commission's consideration of all relevant factors. In the case of the Commission's employment of the hub-and-spoke methodology to review market-based rate applications, the discussion herein reveals that all relevant factors are, in fact, not being considered.

In short, the Commission erred in denying the ICC's request in Exelon Generation Company to discontinue use of the antiquated hub-and-spoke methodology. Nevertheless, the Commission has an

opportunity in this proceeding to remedy this situation by discarding the hub-and-spoke test and replacing it with the more comprehensive and accurate delivered price test. The Commission should do so at this time.

**D. The Illinois Retail Rate Freeze and Phase-In of Retail Competition Should Not Be Considered Mitigating Factors to the Negative Impact of the Hub-and-Spoke Model on the Development of Competitive Wholesale and Retail Markets in Illinois.**

Because of the statutory design for the introduction of retail direct access in Illinois, the most damaging effects of the Commission's flawed hub-and-spoke market power analysis, and the resulting utility opportunities to exercise market power, may not be exposed in Illinois until Illinois' retail rate freeze expires on January 1, 2005. Under Illinois law, retail customers in Illinois are entitled to continue to take bundled service from their existing utility at rates established by the Illinois legislature through January 1, 2005. 220 ILCS 5/16-111(a). Therefore, in an absolute sense, Illinois retail customers cannot be made worse off in the short-run through increased retail rates by the ability to exercise market power during the period of the retail rate freeze.

However, in a relative sense, retail customers are made worse off, even in the short-run, if the ability to exercise market power dampens the development of a vigorous competitive market that might otherwise benefit retail customers as compared with the legislatively established bundled retail rate. In addition, a flawed wholesale market retards the development of the necessary precursors to the competition that would otherwise be achievable in the unbundled retail market. In other words, effectively competitive retail markets simply cannot develop in the absence of effectively competitive wholesale markets. The Illinois legislature recognized this market feature and directed the ICC to promote the development of competition in the wholesale markets as well as the retail markets as a



necessary means to developing competition in the retail markets. See, 220 ILCS 5/16-101A.

The Commission's use of the hub-and-spoke methodology, rather than the delivered price test, to assess market power is likely to permit the exercise market power during Illinois' retail rate freeze period and afterward. The ability to exercise generation market power in association with vertical control over the transmission system<sup>11</sup> creates conditions that are not conducive to the development of effectively competitive wholesale and retail markets. Particularly in Illinois, the concentration of utility/affiliate ownership/control over generation supply and the limited amount of transmission capability into Illinois, in association with vertical control over the transmission system, does immediate damage to the development of wholesale and retail competition by perpetuating barriers to potential market entrants. As a result, choice for the majority of Illinois retail customers may be more illusory than real. While no Illinois retail customers will be legally captive (through legislation or regulation) to their utilities after May 1, 2002, many are likely to remain economically and practically captive even after May 1, 2002, because of the limited availability of genuine wholesale generation supply alternatives. This is an immediate harm although the damage done may not be fully exposed through increased retail rates until after the Illinois retail rate freeze is lifted on January 1, 2005.

Moreover, if the Commission waits until the market damage is exposed after the end of the Illinois retail rate freeze, there will be no available tools left for the Commission or the ICC to retroactively address the market damage actually done, and there will be no tools or few tools available for the Commission or the ICC to address in a timely manner the market damage on a prospective basis. Given the immediacy of the harm to the marketplace and the difficulty in undoing damage that

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<sup>11</sup> While Order 2000 is designed to reduce the negative effects of utility vertical control, the ICC has little hope that an effective RTO will be operating in the Midwest in the short-run.

may be done, the Commission must act now to select a method of market analysis that will expose the ability of power sellers to exercise market power. The Commission should do so by adopting the delivered price test to evaluate market power in the Commission's review of market-based rate applications on a prospective basis. The delivered price test will expose the opportunities of sellers to exercise market power, leading market participants to take action during the interim period that will lead to the creation of an effectively competitive wholesale and retail market in Illinois before January 1, 2005. If the Commission does not act now to establish the proper market analysis standard to be applied to market-based rate requests, utility sellers will have no reason to take the necessary steps to reduce the current market power problems.

#### IV. CONCLUSION

WHEREFORE, for the aforementioned reasons, the Illinois Commerce Commission respectfully requests that the Commission: (1) replace the hub-and-spoke test with the delivered price test to evaluate CILCO's request for continued market-based rate authority in this proceeding; (2) discontinue use of the hub-and-spoke test in all future market-based rate applications; and (3) clarify that CILCO must file notification of changes in circumstances that would affect the Commission's conclusion in this proceeding within ten days of such changes. The Illinois Commerce Commission also seeks any and all other appropriate relief.

June 27, 2001

Respectfully submitted,

ILLINOIS COMMERCE COMMISSION

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CERTIFICATE OF SERVICE

I hereby certify that I caused a copy of the Comments of the Illinois Commerce Commission to be served this day upon each person designated on the official service list compiled by the Secretary in this proceeding, a copy of which is attached, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Chicago, Illinois, this 27th day of June, 2001.

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Sarah A. Naumer  
Special Assistant Attorney General  
Illinois Commerce Commission